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September 18, 2018

Secretary  
Securities and Exchange Commission  
100 F Street N.E.  
Washington, D.C. 20549-1090

Re: File Number S7-16-18

Dear Chair Clayton and Members of the Commission:

Thank you for the opportunity to comment on the Securities and Exchange Commission (SEC or the Commission) proposal to amend its regulations implementing the whistleblower provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

The Dodd-Frank Act's whistleblower provisions have had a "transformative impact on enforcement" of investor protection laws.<sup>1</sup> Many organizations, including companies and governments agencies, fail to appreciate the value of dissenting voices within to ensure compliance with rules and to maintain the trust of those the organization interacts with and the broader public. Whistleblowers play a critical role in our ability to enforce rules in a corporate context. Without enforcement, laws and regulations are useless, and effective enforcement requires the ability to detect when rules are broken.

Those who control corporations have potentially weak incentives to ensure compliance with rules meant to protect investors, customers, employees or the public, particularly if the evasion of the rule remains undetected. They may in fact benefit personally from some wrongdoing within the corporation and might put in place incentives for others to evade the rules for the purpose of improving metrics associated with "shareholder value" or their compensation such as accounting profits or share prices.

In this environment, potential whistleblowers face grim ethical, financial, and social choices. As discussed in more detail below, whistleblowers pay an immediate cost along multiple dimensions while being unsure that they would recover even their direct and indirect financial loss, let alone ever be fully compensated for such things as anguish and social isolation. We must ensure that

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<sup>1</sup> Chair Mary Jo White, "A New Model for SEC Enforcement: Producing Bold and Unrelenting Results," Nov. 18, 2016, available at: <https://www.sec.gov/news/speech/chair-white-speech-new-york-university-111816.html>

whistleblowers are able to express their concerns with the knowledge that the proper action will be taken as a result of their reports. We must also do our best to reduce the cost of whistleblowing and ensure that legitimate and honest reports do not lead to retaliation.

There is reason for concern about the current treatment of whistleblowers by corporations and government agencies. For example, in the case of Wells Fargo Bank's account sales practices scandal, an audit by the Office of the Comptroller of the Currency's ombudsman found both that Wells Fargo executives dismissed the seriousness of 700 whistleblower complaints that had been brought to their attention, and that the OCC lacked proper procedures to pursue the 14 whistleblower complaints that it had received.<sup>2</sup>

In another recent example, in 2017, the CEO of one of the world's largest banks, Barclays, was fined for pursuing a whistleblower who had raised issues about one of the company's executives who was close to the CEO, despite being warned by compliance staff and the general counsel against taking such retaliatory actions.<sup>3</sup>

Last week, on September 11, 2018, there were reports that the prospective Chairman and CEO of the nation's fifth-largest bank holding company, Goldman Sachs, responded to a whistleblower complaint by urging the whistleblower to "let go of his grievances and focus instead on his job," and dismissing troubling behavior as simply reflecting "the way Wall Street worked[.]"<sup>4</sup>

In the case of the laboratory startup Theranos, whose top executives were charged by the Commission with securities fraud,<sup>5</sup> one whistleblower was berated by a company executive; threatened by his employer with legal action over disclosing trade secrets necessitating \$400,000 in legal expenses; and was pressured by his family and the company's outside legal counsel.<sup>6</sup>

In short, while progress has been made in furthering support for whistleblowers, there is clearly more work to be done. With that in mind, we offer the following comments on the SEC's proposed whistleblower amendments.

## **1. The Commission should expand the definition of "action" to include all Deferred Prosecution Agreements and Non-prosecution Agreements**

The problem of how to detect law evasion and create proper accountability in a corporate context is deep and complex. The best policies in this regard would need to address many factors, and

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<sup>2</sup> See Office of Enterprise Governance and the Ombudsman, Office of the Comptroller of the Currency, "Lessons Learned Review of Supervision of Sales Practices at Wells Fargo" at 5, 7, Apr. 19, 2017, available at: <https://www.occ.gov/publications/publications-by-type/other-publications-reports/pub-wells-fargo-supervision-lessons-learned-41917.pdf>

<sup>3</sup> See Max Colchester, *Barclays CEO's Penalties Over Whistleblower Saga Top \$1.5 Million*, WALL ST. J., May 11, 2018, available at: <https://www.wsj.com/articles/barclays-ceo-jes-staley-is-hit-with-u-k-fine-of-about-850-000-1526035711>.

<sup>4</sup> Emily Flitter, Kate Kelly & David Enrich, *A Top Goldman Banker Raised Ethics Concerns. Then He Was Gone.*, N.Y. TIMES, Sept. 11, 2018, available at: <https://www.nytimes.com/2018/09/11/business/goldman-sachs-whistleblower.html>.

<sup>5</sup> See *S.E.C. v. Holmes, et al.*, Case No. 5:18-cv-01602 (N.D. Cal., Mar. 14, 2018) available at: <https://www.sec.gov/litigation/complaints/2018/comp-pr2018-41-theranos-holmes.pdf>

<sup>6</sup> See John Carreyrou, *Theranos Whistleblower Shook the Company—and His Family*, WALL ST. J., Nov. 18, 2016, available at: <https://www.wsj.com/articles/theranos-whistleblower-shook-the-companyand-his-family-1479335963>

would require comprehensive reforms that address the incentives and information asymmetries of everyone involved. A full discussion of the issues is beyond the scope of this comment letter.<sup>7</sup>

The SEC's proposal to expand the scope of whistleblower award-eligible actions to include all deferred prosecution agreements (DPAs) and non-prosecution agreements (NPAs) is a step in the right direction. Whistleblowers should not be penalized as a result of the government's decision to pursue a particular litigation strategy. The agency, in turn, must make its decisions on the merit of each case using the full range of legal options without the whistleblower award potentially distorting these decisions.

Beyond this useful step in the short run, the Commission should seriously reconsider its policies favoring settlements, DPAs, and NPAs with corporations and rarely pursuing responsible individuals, particularly higher up in the corporation. These practices create the impression that corporations paying fines is "the cost of doing business" and that little is done to create proper accountability or deter future law evasion.<sup>8</sup>

## **2. The Commission should not decrease the maximum amount of whistleblower awards**

The Commission's proposal would give the SEC discretion to limit the recovery for all whistleblowers in cases where the penalty exceeds \$100 million to the greater of either 10 percent of the penalty or \$30 million.<sup>9</sup> We are concerned that the proposed approach will weaken the whistleblower program for the following reasons.

- A. The proposal introduces uncertainty that could reduce the incentives of potential whistleblowers to come forward.

Monetary incentives have been found to motivate people to blow the whistle.<sup>10</sup> One whistleblower called the potential of an award "a powerful incentive."<sup>11</sup> Encouraging more reports of potential wrongdoing requires rules that govern the consequences for the person reporting to be as clear, unambiguous, and uniform as possible. The goal of whistleblower awards should be to pay the highest amount possible so that the combined probability of recovery and the amount of the award match or exceed the overall costs to blowing the whistle,

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<sup>7</sup> Jesse Eisinger, *THE CHICKENSHIT CLUB: WHY THE JUSTICE DEPARTMENT FAILS TO PROSECUTE EXECUTIVES* (Simon & Schuster 2017), for example, discusses some of the issues.

<sup>8</sup> See Jed S. Rakoff, *Justice Deferred Is Justice Denied*, N.Y. REV. OF BOOKS, Feb. 19, 2015, available at <https://www.nybooks.com/articles/2015/02/19/justice-deferred-justice-denied/>.

<sup>9</sup> The Commission's proposed revisions reference four of the SEC's 55 whistleblower awards, which the Commission appears to believe may have been excessive, necessitating the proposed amendments. See 83 Fed. Reg., at 34,703. These payouts involved only two SEC actions. In all, it appears that the maximum amount by which the Commission might be able to reduce the cumulative awards under its proposal may be \$27 million. (One award was between \$30 million and \$35 million. See Securities & Exchange Comm'n, Order Determining Whistleblower Award Claim, File No. 2014-10, Sept. 22, 2014, available at: <https://www.sec.gov/rules/other/2014/34-73174.pdf>. The other awards were \$49 million and \$33 million. See Securities & Exchange Comm'n, Order Determining Whistleblower Award Claim, File No. 2018-6, Mar. 19, 2018, available at: <https://www.sec.gov/rules/other/2018/34-82897.pdf>.)

<sup>10</sup> See Alexander Dyck, Adair Morse & Luigi Zingales, Who Blows the Whistle on Corporate Fraud? 4, Chicago GSB Research Paper No. 08-22 (Oct. 1, 2008) available at SSRN: <https://ssrn.com/abstract=891482>.

<sup>11</sup> See Eric Ben-Artzi, *We Must Protect Shareholders from Executive Wrongdoing*, FIN'L TIMES, Aug. 18, 2016, available at: <https://www.ft.com/content/b43d2d96-652a-11e6-8310-ecf0bddad227>.

without encouraging frivolous claims.<sup>12</sup> It is difficult to know exactly what the specific thresholds are, and they may differ for different individuals and contexts (for example, depending on the whistleblower status, employability elsewhere, how many others can corroborate the report, etc.).<sup>13</sup>

Whistleblowing almost always imposes high costs on the whistleblower. Retaliation of some sort is pervasive and may occur before any agency action once the corporation suspects or finds out about the report. Whistleblower awards, however, if any, are likely to take years to come about. The legal prohibitions against retaliation do not change the reality that whistleblowers can be marginalized within their own firms, demoted or terminated on the basis of supposedly unrelated reasons that are hard to fight, or quit under duress.<sup>14</sup> Whistleblowing can effectively end their careers.<sup>15</sup>

Executives and even lower-level employees who leave their firms may be subject to non-disclosure agreements that expose them to legal liability or forfeiture of vested compensation or severance pay and which may interfere with their ability to find another job.<sup>16</sup> Some research suggests that compensation arrangements like stock option grants may offer an additional financial disincentive to whistle blowing.<sup>17</sup>

In addition to financial costs, whistleblowing can impose psychic costs like emotional distress and social alienation.<sup>18</sup> It may also impact the quality of their lives by forcing them to move to another state, city, or town to avoid retribution.<sup>19</sup>

The SEC and other relevant agencies, and individuals within the agencies, have discretion in deciding whether to initiate an enforcement action and, more generally, their response to whistleblowers' report, the amount of the penalty, and the bounty to be paid as whistleblower award.<sup>20</sup> The agencies and their personnel may be subject to direct or indirect pressures from the corporations being reported.<sup>21</sup> For a prospective whistleblower, these dynamics introduce additional uncertainty into any calculation of the likelihood of receiving any whistleblower award, and thus into the decision whether to come forward. Ideally, the whistleblower would

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<sup>12</sup> See, e.g., David Freeman Engstrom, *Bounty Regimes 7-8*, Stanford Public Law Working Paper (June 22, 2017) available at: <https://ssrn.com/abstract=2991387>.

<sup>13</sup> Yehonatan Givati, *A Theory of Whistleblower Rewards*, 45 J. OF LEGAL STUDIES 43 (Jan. 2016) offers a theoretical discussion of the issues.

<sup>14</sup> See Dyck, Morse & Zingales, *supra*, at 23.

<sup>15</sup> See Anat R. Admati, *It Takes a Village to Maintain a Dangerous Financial System 8*, Working Paper, May 31, 2016, available at <http://bankersnewclothes.com/wp-content/uploads/2016/11/Takes-a-Village-final.pdf>; see also Dyck, Morse & Zingales, *supra*, at 23 (“The lawyer of James Bingham, a whistleblower in the Xerox case, sums up Jim’s situation as: ‘Jim had a great career, but he’ll never get a job in Corporate America again.’”); see also Ben-Artzi, *supra* (“I did not agree and was fired. My Wall Street career was ruined.”).

<sup>16</sup> See Flitter, Kelly & Enrich, *supra*, note 4.

<sup>17</sup> See, e.g., Andrew Call, Simi Kedia & Shivaram Rajgopal, *Blinded by Incentives: Do Rank and File Stock Options Deter Employee Whistle-Blowing?*, AFA 2013 San Diego Meetings Paper (Feb. 15, 2012) available at: <https://ssrn.com/abstract=2023596>.

<sup>18</sup> See Dyck, Morse & Zingales, *supra*, at 23.

<sup>19</sup> See *id.*

<sup>20</sup> See Engstrom, *supra*, at 4.

<sup>21</sup> See William Cohan, *Was This Whistleblower Muzzled?*, N. Y. TIMES, Sept. 21, 2013, available at: <https://www.nytimes.com/2013/09/22/opinion/sunday/was-this-whistle-blower-muzzled.html>.

have more options than depending fully on the agency's action on the report, akin to the *qui tam* provision of the False Claims Act.<sup>22</sup>

The whistleblower may also not be in a position to evaluate the legality of the behavior he or she observed, which might require significant legal expertise. The act of whistleblowing has the potential to expose whistleblowers to the risk, or perceived risk, of civil or criminal liability.<sup>23</sup> This problem can arise in a variety of whistleblower contexts, ranging from whistleblowers who have had a minimal role in some illegal acts or schemes to whistleblowers who incorrectly believe that they may have participated in illegal behavior.<sup>24</sup> The result is fewer potential whistleblowers.

A survey of whistleblowers quoted many respondents as saying, "If I had to do it over again, I wouldn't."<sup>25</sup> In the face of all of the potential cost and uncertainty outlined above, it is important for the SEC to provide as much clarity as possible about both the likelihood of financial recovery and the potential amount. The Commission should explore ways to encourage more honest whistleblowing, not introducing additional uncertainty into what is already a difficult situation for potential whistleblowers.

B. The Commission's proposal fails to establish that the costs of the current system are excessive.

There is no evidentiary basis for the claim that the largest whistleblower bounties are excessive. The Commission's proposal looks at "net worth" and says that the awardee would be among the upper echelons of the wealthiest Americans, and also cites comparisons to average industry wages.

A whistleblower is likely to have little if any future employment opportunity within or even outside the industry.<sup>26</sup> The proper benchmark for an award amount is not how the whistleblower would compare with the rest of society, but rather the whistleblower's future income after blowing the whistle. For certain industries and executives, the cumulative amount of such a calculation would likely be quite high.

While not directly analogous, the availability of *qui tam* lawsuits has been found to encourage whistleblowing.<sup>27</sup> Such suits may result in awards that exceed the Commission's largest bounties that this proposal would limit, suggesting that the awards are in line with other compensation mechanisms.<sup>28</sup>

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<sup>22</sup> See 31 U.S.C. § 3730.

<sup>23</sup> See Miriam H. Baer, *Reconceptualizing the Whistleblower's Dilemma*, 50 U.C. DAVIS L. REV. 2215, 2227 (2017); see also *id.*, at 2271-72.

<sup>24</sup> See *id.*, at 2241-50.

<sup>25</sup> Dyck, Morse & Zingales, *supra*, at 5.

<sup>26</sup> By stark contrast, as shown in a paper by Amit Seru and others, people with history of misconduct seem to have little trouble finding employment quickly, especially if they are males. See Mark Egan, Gregor Matvos & Amit Seru, *The Market for Financial Adviser Misconduct*, Working Paper, Jan. 2017, available at <https://www.gsb.stanford.edu/sites/gsb/files/publication-pdf/ssrn-id2739170.pdf>.

<sup>27</sup> See *id.*, at 24 (note that this study was conducted before passage of the Dodd-Frank Act).

<sup>28</sup> See *id.* (citing three settlements of \$35 million, \$35 million, and \$70 million).

The proposal notes that any funds from the settlements that are not paid to the whistleblower would go to the United States Treasury.<sup>29</sup> Unlike whistleblower bounties, this use of the funds does not provide benefits to society in terms of detecting, deterring, or punishing wrongdoing. The SEC should not prioritize funding unidentified government programs over its own missions of investor protection and ensuring orderly and efficient markets that are “vital to the capital markets and investors.”<sup>30</sup>

C. The proposal’s minimums and caps will reduce the incentives of high-level whistleblowers to come forward.

Rather than considering a downward adjustment in the whistleblower reward that could make the tradeoffs even less attractive to high-ranking executives, the Commission should revise the rules so that they encourage more high-level whistleblowing from those within the corporation who have greater access to information but who are also likely to have a greater sense of allegiance to their company.<sup>31</sup> The monetary cap and potential downward adjustment in the Commission’s proposal runs counter to such an approach.

The Commission acknowledges that only 10 percent of the current whistleblower award recipients are “high-ranking corporate executives.”<sup>32</sup> By simultaneously increasing the smallest awards and decreasing the largest awards, as outlined in its proposal, the SEC risks encouraging more low-level employees to report minor fraud while potentially deterring high-level executives from reporting major fraud. Such a change could have the effect of furthering the “broken windows” type of enforcement for which the Commission has been criticized in the past.<sup>33</sup>

### **3. Rather than reducing whistleblower awards, the Commission should focus on holding individuals within the corporation more accountable, including senior managers.**

Consistent with the concerns with the lack of individual accountability raised above, penalties against executives in the whistleblowing context are insufficient. For example, Barclays’ CEO, mentioned above, was fined \$868,501 by U.K. regulators and docked £500,000 for pursuing a whistleblower.<sup>34</sup> Experts characterized the penalty as “pitifully low,” but regulators reportedly chose not to take more punitive steps – including removing the C.E.O. – for fear that such actions could destabilize the bank.<sup>35</sup>

Rather than revising the rules to limit payouts to whistleblowers whose claims have been validated, the SEC should do better to hold individual executives accountable, consistent with the priorities laid out by its former Chair.<sup>36</sup> One way of doing this, proposed by a past SEC

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<sup>29</sup> See 83 Fed. Reg., at 34,715.

<sup>30</sup> Chair Mary Jo White, “The Importance of Independence,” Oct. 3, 2013, available at: <https://www.sec.gov/news/speech/spch100113mjw>

<sup>31</sup> See Engstrom, *supra*, at 25. For example, some have suggested an increase in the percentage of bounty recovery as the magnitude of the underlying fraud increases. See *id.*, at 9.

<sup>32</sup> 83 Fed. Reg., at 34,735.

<sup>33</sup> Commissioner Michael S. Piowar, “Remarks to the Securities Enforcement Forum 2014,” Oct. 14, 2014, available at: <https://www.sec.gov/news/speech/2014-spch101414msp>.

<sup>34</sup> See Colchester, *supra*, note 3.

<sup>35</sup> See *id.*

<sup>36</sup> See White, “A New Model for SEC Enforcement,” *supra*, note 1.

whistleblower, is to claw back the amount of any award – or a portion of the overall fine itself – from responsible executives.<sup>37</sup> For example, Chair White proposed a system such as a “performance bond” that could be made available for such a purpose.<sup>38</sup> In sum, the Commission should use its authority under sections 922 and 956 of the Dodd-Frank Act to hold executives personally responsible for paying whistleblower awards instead of the company’s shareholders.

Thank you again for considering our views on this important rule.

Sincerely,



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Cc: Hon. Kara Stein  
Hon. Hester Peirce  
Hon. Robert Jackson  
Hon. Elad Roisman

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<sup>37</sup> See Ben-Artzi, *supra*.

<sup>38</sup> See White, “A New Model for SEC Enforcement,” *supra*.